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# Forum Juridicum: Federal Gift Tax on Life Insurance in Louisiana - A Critique of Revenue Rulings 48 and 232

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many men of wisdom, character and ability as members of its early courts, it must be conceded that all persons holding judicial positions during that period did not measure up to those standards. The fact that they did not do so, however, has strengthened, rather than weakened, our judicial system because it has served to point out its weaknesses and thus afford an opportunity to make necessary corrections.

The fact that our court structures and judicial procedures have been frequently revised by the adoption of new constitutions, constitutional amendments and legislative acts, may indicate some instability; but I am inclined to feel that on the contrary it indicates progressiveness, a readiness and a willingness to discard the old, unworkable or bad features of our laws, and to adopt new laws which eliminate the undesirable provisions of the old.

A review of this kind causes me to realize more forcefully that the building of our judicial system is a project which is never actually completed. It is a continuing process. We have been provided with a solid foundation but we are still constructing the building, and those of us who are lawyers and judges today are the skilled workers who are performing important tasks in the erection of this structure. Everything we do in the field covered by our chosen profession has the effect of adding another brick to this edifice, and the manner in which we lay these bricks will determine whether the walls will be straight and strong. And so I close with the challenge that we should use care in laying these bricks, so that the structure of the Louisiana judiciary will be sound.

## Federal Gift Tax on Life Insurance in Louisiana: A Critique of Revenue Rulings 48 and 232

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Revenue Rulings 48 and 232, handed down by the Commissioner of Internal Revenue in 1953,<sup>1</sup> hold that if a married man

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1. Rev. Rul. 48, 1953-1 CUM. BULL. 392; Rev. Rul. 232, 1953 INT. REV. BULL. No. 22 at 22.

domiciled in Louisiana purchases an insurance policy in favor of a third-party beneficiary and pays the premium with community funds,<sup>2</sup> the incidents of ownership in the policy being reserved by him, upon his death only one-half of the policy proceeds are includible in his gross estate under Section 811(g)(2) of the Internal Revenue Code,<sup>3</sup> and a gift by the wife to the third-party beneficiary of the remaining one-half of the policy proceeds becomes absolute for federal gift tax purposes. The reason given is that by Article 2404 of the Louisiana Civil Code the husband has the power of management and administration in the one-half of the community property the absolute ownership of which vested in the wife at the time the property was acquired.

Revenue Ruling 48 applies the same rule to a married man domiciled in Texas on the ground that the laws of Texas are similar in these respects to those of Louisiana. The ruling maintains that in both states a life insurance policy taken out on the life of the husband during coverture with community funds, the right to surrender the policy being retained, is a community asset in which the wife has a vested interest; and the wife's transfer of her one-half interest in the policy is not considered absolute prior to the death of the husband.

Actually the rights of Texas widows are different from those of Louisiana widows where community funds are used to pay premiums on policies in favor of third-party beneficiaries. A Texas widow may recover the proceeds of the insurance policy payable to a third-party beneficiary, unless the husband was

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2. Benjamin & Pigman, *Federal Estate and Gift Taxation of Louisiana Life Insurance*, 28 TULANE L. REV. 75 (1953) and 28 TULANE L. REV. 243 (1954) approve of the rulings. They say: "Since the policy-rights in revocable-beneficiary policies acquired by either Louisiana spouse during the existence of the marital community remain vested in the community during its continued existence, the uninsured wife's one-half of the policy-rights are terminated only at the insured's death. At such time, the proceeds vest in the revocably-named beneficiary for the first time. The continuing existence of the uninsured Louisiana wife's policy-rights is recognized by Revenue Rulings 48 and 232. . . . Gift taxation of one-half of the proceeds of a community policy to the uninsured spouse upon the insured spouse's death is consistent with the general Louisiana community property rule that the wife makes a gift by operation of law of one-half the husband's inter vivos gifts of community property to third parties." *Id.* at 278-79.

3. "(2) *Receivable by other beneficiaries.* To the extent of the amount receivable by all other beneficiaries as insurance under policies upon the life of the decedent (A) purchased with premiums, or other consideration, paid directly or indirectly by the decedent, in proportion that the amount so paid by the decedent bears to the total premiums paid for the insurance, or (B) with respect to which the decedent possessed at his death any of the incidents of ownership, exercisable either alone or in conjunction with any other person. . . ."

under a moral obligation to insure his life in favor of the third-party beneficiary (a parent or a child by a former marriage, for example) and the amount expended was not out of proportion to the community assets.<sup>4</sup>

But a Louisiana widow may not recover any part of the insurance proceeds payable to a third-party beneficiary, even when the third-party beneficiary is a concubine with whom the husband had been living in adultery during the marriage.<sup>5</sup>

The courts have held that the Louisiana widow has a vested interest in the community property equal to that of the husband.<sup>6</sup> It has also been said that the wife has a vested interest in insurance policies the premiums on which are paid for with community funds, even though the incidents of ownership are reserved to the husband.<sup>7</sup> But what is the vested interest when, although the husband pays the premiums out of community funds (most of which may have been earned by the wife)<sup>8</sup> on insurance policies in favor of his mistress, the wife may not re-

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4. 1 DE FUNIAK, *PRINCIPLES OF COMMUNITY PROPERTY* § 123 (1943). de Funiak also writes that in the State of Washington a wife is entitled to half the proceeds of the policy, even if the beneficiary was the indigent mother of the husband upon whom a statute imposed a duty of support. He also says that in California the wife is entitled to half of the insurance proceeds even though the beneficiaries were the dependent relatives of the husband.

5. *Prudential Ins. Co. of America v. Taylor*, 46 F. Supp. 115 (W.D. La. 1942).

Cahn, *Louisiana Civil Law as Applied to Life Insurance*, 12 LOUISIANA LAW REVIEW 56, 58 (1951): "[T]he courts of Louisiana have repeatedly maintained the named beneficiary as entitled to the proceeds, against attacks by the surviving spouse; a widow has no right against the proceeds payable . . . to his concubine."

Huie, *Community Property Laws as Applied to Life Insurance*, 18 TEXAS L. REV. 121, 127 (1940): "The Louisiana writers urge that Article 2404 . . . should be applied as a restriction upon the husband's power to use community funds to pay premiums on insurance policies on his life in favor of third persons. . . . The decided cases have upheld the husband's gifts by means of life insurance, however, without indicating that any limitation exists upon his power to so dispose of the community."

In *Toussant v. National Life & Accident Ins. Co.*, 147 La. 977, 86 So. 415 (1920), the wife was originally named as beneficiary but the concubine was later substituted. It was held that the concubine was entitled to the proceeds.

6. *Bender v. Pfaff*, 282 U.S. 127 (1930) (income tax); *Phillips v. Phillips*, 160 La. 813, 107 So. 584 (1926). Cf. DAGGETT, *THE COMMUNITY PROPERTY SYSTEM OF LOUISIANA* 159 (1945), which says of *Bender v. Pfaff*, ". . . the dictum of the Phillips case was the sole reliance so far as citation was concerned for the direct Louisiana recognition of the doctrine that the wife had a present vested interest instead of an expectancy in Louisiana."

7. Benjamin & Pigman, *Federal Estate and Gift Taxation of Louisiana Life Insurance*, 28 TULANE L. REV. 243, 278 (1954).

8. *Houghton v. Hall*, 177 La. 237, 148 So. 37 (1933) held that earnings of a wife living with her husband are community property. Cf. Note, 19 TULANE L. REV. 141, 143 (1944): "[T]he rule of the *Hall* case, to the effect that the wife must be living separate and apart from her husband before her earnings are her own, seems to be a settled rule in Louisiana jurisprudence."

cover any part of the insurance proceeds?<sup>9</sup> If the wife is a famous actress and, as often happens, her husband is her manager, she may find herself at his death asked to pay a handsome gift tax on policies on which her earnings paid the premiums. We believe that it would be a flagrant violation of a widow's rights under the Fifth Amendment to tax her with having made a gift of half the proceeds of an insurance policy taken out by her husband in favor of his mistress because he paid the premiums out of her earnings and reserved the incidents of ownership. Apparently she is being taxed for not marrying a man more generous to his mistress, since if he had not reserved the incidents of ownership she would not be asked to pay a gift tax.

It is submitted that if a Louisiana husband takes out insurance policies in favor of third-party beneficiaries, reserving the incidents of ownership and paying the premiums out of community funds, no part of the insurance proceeds should be taxed to the wife as a gift by her, Revenue Rulings 48 and 232 notwithstanding.

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9. See Note, 17 *TULANE L. REV.* 321 (1942). The note discusses *Prudential Insurance Co. of America v. Taylor*, 46 F. Supp. 115 (W.D. La. 1942), in which a husband named his daughter in 1939 as beneficiary of an insurance policy and in 1941 substituted his concubine as the beneficiary. The insurance company in an interpleader action cited the concubine, the widow and daughter as defendants and claimants to the insurance proceeds; the federal district court granted the concubine's motion for summary judgment. The note continues that the doctrine is firmly established in Louisiana that the proceeds of a life insurance policy form no part of the estate of the deceased, but become the property of the beneficiary by the terms of the contract itself.